The Manufacturers Hanover
# Financial Digest
Weekly Commentary, Selected Financial Data, and Business Indicators

MONDAY, JULY 25, 1983 VOLUME XX, NUMBER 28

## A Balanced Monetary Policy . . .

Last week's testimony by Federal Reserve Chairman Paul A. Volcker before various Congressional forums should be welcomed by the financial markets, as well as just about everyone else. For in recognition of the need to keep both the domestic and global business recoveries solidly on track, Mr. Volcker emphasized that not only has the restraint applied to date been modest, but it is now being accompanied by a lifting of the M1 money supply growth targets for the remainder of this year. This combination of restraint and generosity seems to have set the stage for within-target money growth—and, hopefully, lower interest rates.

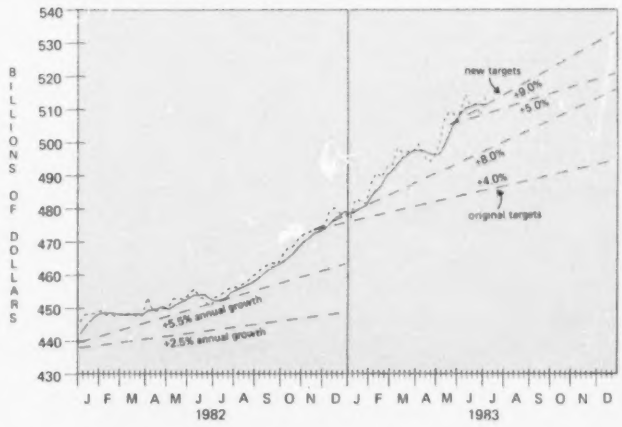
According to Chairman Volcker, the decision to lift 1983's M1 growth targets was taken at the mid-July meeting of the policy-setting Federal Open Market Committee. To be sure, this action became almost a necessity in light of the emerging pace of business activity and trends in the money supply. Take the economy, for example. Although more than one third of the second quarter's 8.7 per cent real GNP gain (seasonally adjusted annual rate) was due to a slowing of inventory liquidation, several other signs indicate that the recovery's strong momentum was more fundamental in nature. Auto sales in June ran at their fastest clip in almost two years, housing starts remained at lofty levels and factory orders, industrial production and capacity utilization rates are all rising nicely.

But while this may have been good news for the economy, its effects on the credit markets are much less clear. Household credit demands, fueled by a steep upturn in housing- and auto-related borrowings, have begun to advance briskly compared with year-earlier levels, while an upturn in business borrowings may develop once inventory liquidation comes to an end. And with little or no progress being made in paring Washington's credit needs, any vigorous snapback in private credit demands can only hasten the long-anticipated clash between public and private borrowings. So if today's more rapid-than-anticipated economic growth was to be sustained, it had to be accompanied by monetary policy accommodation somewhat more generous than originally planned.

## . . . Sets The Stage . . .

Complicating the Fed's job is the fact that the financial markets remain mesmerized by the money supply numbers. With the robust pace of business activity swelling its transactions components, and deposit innovation affecting its interest-sensitive components, M1 has been, to say the least, difficult to tame. It expanded at a hefty 16 per cent seasonally adjusted annual rate over the past eight weeks and, by the first week in July, stood a sizable $16.5 billion above its eight per cent upper growth target boundary—prompting the markets to mark up interest rates in anticipation of a tighter monetary policy.

MONEY SUPPLY, M1
FOUR-WEEK MOVING AVERAGE (LINE) VS. WEEKLY FIGURES (DOT)




For the Federal Reserve, however, the question of what to do about the M1 money supply was somewhat more complex. It had to balance the requirements of keeping the recovery on track, against the need to maintain its inflation-fighting credibility. Nor was the appropriate policy response all that clear, since no one is really sure whether or not trends in M1 are any longer reliable guides to future business and price developments.

The Fed thus found itself confronting a mid-summer's dilemma—with policy options ranging from vigorous restraint to doing nothing. But since restraint sufficient to eliminate the nagging M1 money bulge would probably derail recovery, and

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doing nothing could rekindle inflation expectations, the Fed did the next best thing—it chose a middle course. A discreet tightening of the monetary reins was initiated—one which first got underway last spring. This included scaling back the provision of nonborrowed reserves to the banking system, a slightly higher Federal funds rate and the tolerance of modest increases in all other interest rates. The advantage of this approach is that while it maintained the Fed's inflation-fighting credibility, it presented little risk to both the U.S. and international economic recoveries.

To be sure, these steps will probably slow the above-target money growth, but the question remained what to do about the existing money supply bulge. In recognition of the fact that M1 has been distorted for some time by a variety of technical and regulatory changes, the Fed decided that it would be more expedient to move the money supply targets closer to the money supply, rather than the other way around—something of the monetary policy equivalent of the old saying, "If the mountain won't come to Mohammed, Mohammed will go to the mountain."

As a result, M1 was rebased, more generous growth targets were set for the remainder of this year and the existing M1 money growth targets were scrapped. And, as shown in the chart, in one bold stroke, the central bank virtually eliminated the existing M1 bulge; as of the first week in July, M1 stood only $2.7 billion above the Fed's revised, nine per cent upper target limit.

## Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

| | Week Ending 7/13/83 | $ Change Since Week Ago | $ Change Since Year Ago |
|---|---|---|---|
| Reserve Bank Credit | | | |
| U.S. Gov'ts and Agencies Owned Outright & RPs | 152.049 | – .106 | +11.251 |
| Loans to Depository Inst. | 1.147 | – 1.088 | + .588 |
| Float | 2.644 | + .508 | – .222 |
| Total Reserve Bank Credit | 164.476 | – .658 | +11.416 |
| Treasury Deposits with Federal Reserve Banks | 4.498 | + .044 | + 1.149 |
| Currency Outside Banks | 144.532 | + .524 | +11.847 |
| Member Bank Reserves: | | | |
| Required | 37.245 | – .827 | – 1.681 |
| Excess (Deficiency) | .450 | – .428 | + .266 |
| Total Reserves Held | 37.695 | – 1.255 | – 1.415 |
| Net Borrowed Reserves | .119 | + .008 | + .045 |
| Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week) | 110.711 | + .762 | +13.986 |
| **Monetary Aggregates †** | | **% Change Since Three Months Ago*** | **% Change Since Year Ago** |
| M1 | 514.6 | + 11.8‡ | + 13.2‡ |
| M2 (June '83) | 2,115.2 | + 8.8 | + 13.4 |
| M3 (June '83) | 2,498.9 | + 8.5 | + 10.6 |
| Domestic Nonfinancial Debt (1st Q'83) | 4,855.3 | + 8.9 | + 9.8 |

†Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

## New York Money Market

| Offering Rates 7/22/83 | 3 Months | 6 Months | 1 Year |
|---|---|---|---|
| ‡U.S. Treasury Bills | 8.60% | 8.80% | 9.00% |
| * Federal Agencies | 9.50 | 9.75 | 10.25 |
| * Project Notes—Taxfree (46% Taxable Equivalent) | 8.43 | 8.80 | 10.65 |
| Negotiable Time CDs Manufacturers Hanover | Rates By Arrangement | | |
| * Secondary Market—Prime | 9.55 | 10.00 | 10.50 |

‡Finance Company Paper—Prime

| | |
|---|---|
| 5- 14 days | 9.00% |
| 15- 29 days | 9.13 |
| 30- 59 days | 9.25 |
| 60- 89 days | 9.25 |
| 90-179 days | 9.25 |
| 180-239 days | 9.25 |
| 240-270 days | 9.25 |

‡* Bankers' Acceptances

| | |
|---|---|
| Aug. | 9.25% |
| Sep. | 9.30 |
| Oct. | 9.35 |
| Nov. | 9.40 |
| Dec. | 9.50 |
| Jan. | 9.45 |

‡Industrial Paper—Prime

| | |
|---|---|
| 30- 89 days | 9.13% |
| 90-120 days | 9.25 |

†Federal Funds Effective Rate 9.50%

‡Discount basis. * Subject to availability. † Estimated.

## Selected Business Indicators

(All Dollar Figures In Billions)

| | Latest Period or End of Period | | Previous Period | Year Ago Period |
|---|---|---|---|---|
| Gross National Product (Current Dollars)* | 2nd Q'83n | $ 3,274 | $ 3,172r | $ 3,070r |
| Gross National Product (1972 Dollars)* | 2nd Q'83n | $ 1,521 | $ 1,490r | $ 1,489r |
| Percent Change, Annual Rate | 2nd Q'83n | 8.7 | 2.6r | 0.9r |
| Change in Consumer Prices (new series)* | Jun '83n | 2.4% | 6.0% | 13.2% |
| Change in Producer Prices* | Jun '83n | 6.0% | 3.6% | 12.0% |
| Civilian Employment (Thousands of Persons) † | Jun '83 | 100,786 | 99,557 | 99,681 |
| Unemployment as % of Civilian Labor Force † | Jun '83 | 10.0% | 10.1% | 9.5% |
| Personal Income* | Jun '83n | $ 2,734 | $ 2,721r | $ 2,573r |
| Leading Indicators Composite Index (1967=100) † | May '83 | 154.5 | 152.6 | 136.2 |
| Industrial Production Index (1967=100) † | Jun '83n | 145.9 | 144.3 | 138.7 |
| Net Change in Consumer Installment Credit † | May '83n | $ 2.70 | $ 2.27 | $ 1.84 |
| U.S. Merchandise Trade Balance † | May '83 | –$ 6.91 | –$ 4.60 | –$ 3.30 |
| Plant and Equipment Expenditures* | 3rd Q'83 | $306.83(a) | $302.23(a) | $315.79 |
| Private Housing Starts (Thousands of Units)* | Jun '83n | 1,747 | 1,799r | 910 |
| New Construction Expenditures* | May '83 | $ 253.0 | $ 245.6 | $ 230.9r |
| Total Business Inventories † | May '83n | $ 506.5 | $ 504.8r | $ 519.1 |
| Total Business Sales † | May '83n | $ 363.1 | $ 351.4r | $ 353.1 |

*Seasonally adjusted annual rate. †Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

### . . . For Lower Interest Rates

Thus, as Chairman Volcker appeared before Congress, he was well positioned to mollify conservatives and liberals, monetarists and Keynesians. To those urging restraint, the Fed Chairman could point to recent trends in non-borrowed reserves—the building blocks of the money supply. During the past 13 weeks, nonborrowed reserves have contracted at a five per cent seasonally adjusted annual rate, a sharp turnaround from the nine per cent seasonally adjusted annual rate expansion posted during the immediately preceding 13 weeks. To those urging additional policy accommodation, Chairman Volcker could point to the more generous M1 growth targets—as well as the "forgiveness" of the huge money bulge which had developed during the first half of the year. With the bulge now incorporated into the target's base, aggressive restraint would clearly not be needed to eliminate it.

What does it all mean—this combination of restraint and generosity? For one thing, with money supply growth likely to be within target fairly soon as a result of steps already taken, interest rates should drift lower in coming weeks. This is because as fears of a Fed tightening in response to above-target money growth recede, some of the recent financial market turbulence will evaporate. But, perhaps most important, the central bank has bought more time for the recovery to proceed—and, of course, for the Federal government to put its financial house in order. H

## Short Term Paper Outstanding

(Millions of Dollars)

| | Latest Week | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| **Negotiable Time CD's Weekly Reporting Banks** | | | |
| Nationwide (7/6/83) | 95,777 | – 917 | –42,361 |
| New York City (7/6/83) | 22,356 | + 191 | –12,683 |
| **Commercial Paper** (7/6/83) | 170,216 | – 3,401 | +11,596* |

*Series redefined: Data prior to December 1, 1982, are not strictly comparable to the data reported after that date.

## Bank Loans

(Millions of Dollars)

**Commercial and Industrial Loans**

| Weekly Reporting Large Commercial Banks | Latest Week | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| Nationwide (7/6/83) | 215,047 | + 1,717 | + 1,975 |
| New York City (7/6/83) | 58,458 | + 1,216 | – 1,913 |

**Total Loans Gross Adjusted**

| | Latest Week | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| Nationwide (7/6/83) | 508,376 | + 2,310 | +15,092 |
| New York City (7/6/83) | 118,693 | + 1,511 | + 3,561 |

## Financial Markets

| | Friday 7/22/83 | Change Since Week Ago | Change Since Year Ago |
|---|---|---|---|
| **U.S. Governments, Closing Yields:** | | | |
| 90-Day Bills† | 9.52% | + .08 | – 1.20 |
| 180-Day Bills† | 9.92 | + .01 | – 1.88 |
| Longest Bills† | 10.30 | + .03 | – 2.10 |
| **Recent Issues:** | | | |
| 10⅝s 7/31/85 (When Issued) | 10.88 | NA | |
| 10½s 6/30/87 | 11.27 | + .10 | |
| 10⅛s 5/15/93 | 11.60 | + .15 | |
| 10⅜s 11/15/12 | 11.57 | + .17 | |
| **Municipals:** | | | |
| Bond Buyer–20 Bond Index* (7/21/83) | 9.44% | – .10 | – 2.57 |
| Blue List Total ($ Million) | $1,047 | –$ 822 | + $265 |
| 30-Day Visible Supply ($ Million) | $2,895 | +$1,236 | + $288 |
| Total | $3,942 | +$ 414 | + $553 |
| **Corporates:** | | | |
| Moody's Aa Composite (7/21/83) | 12.43% | 0.00 | – 2.53 |
| 30-Day Visible Supply ($ Million) | $ 420 | –$ 96 | – $715 |
| **Stocks:** | | | |
| **Dow-Jones Averages:** | | | |
| Industrials | 1,231.17 | + 38.86 | + 400.60 |
| Transportation | 579.06 | + 17.75 | + 260.71 |
| Utilities | 131.50 | + 1.29 | + 25.05 |
| 65 Stocks | 491.41 | + 14.02 | + 471.89 |
| **Standard and Poor's 500 Stocks** | 168.89 | + 4.60 | + 57.72 |
| **N.Y.S.E. Composite Index** | 97.74 | + 2.46 | + 33.93 |
| **N.Y.S.E. Avg. Daily Vol. for Week (000's)** | 84,690 | +15,202 | + 28,254 |

* 46% Taxable equivalent 17.48%.

† Bond equivalent.

## International Rates

| EURODOLLAR DEPOSIT RATES (bid) | Friday 7/22/83 | Week Ago |
|---|---|---|
| Overnight | 9.38% | 9.25% |
| 1 month | 9.56 | 9.69 |
| 3 month | 9.94 | 10.06 |
| 6 month | 10.38 | 10.56 |
| 1 year | 10.63 | 10.69 |
| **EURODOLLAR BONDS** | | |
| **Average Yield** | | |
| Medium Term (5 to 7 yrs.) | 11.65% | 11.70% |
| Long Term (7 to 15 yrs.) | 11.65 | 11.70 |

**FOREIGN EXCHANGE SPOT RATES**

| New York Opening (7/22/83) | U.S. $ Equivalent | Currency Per U.S. $ |
|---|---|---|
| Belgium | .01931 | 51.78 |
| Canada | .8106 | 1.2336 |
| Denmark | .1074 | 9.3135 |
| France | .1285 | 7.7845 |
| Germany | .3865 | 2.5875 |
| Italy | .0006532 | 1531.00 |
| Japan | .004167 | 239.98 |
| Mexico | .006711 | 149.00 |
| Netherlands | .3455 | 2.8945 |
| Switzerland | .4760 | 2.1008 |
| U.K. | 1.5240 | .6562 |

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